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Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

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The persisting improvement in bond prices even in the face of a sharp rise in the index of leading economic indicators demonstrates a strong upward momentum in bond prices. Although the leading economic indicators were augmented by a purely technical kick from the distorted monetary aggregate M2, the 3.6% rise in January was impressive. That bond prices continued to firm indicates a more fundamental and less technical reaction in the bond market itself. The bond market is beginning to focus more on long-term trends and is putting less weight on the likely reaction of the Federal Reserve. This development is due to several factors.

The gestation period following Chairman Volcker's Senate Banking Committee testimony is over. The result is that near-term fears of higher interest rates are removed. While uncertainty exists as to whether or not money market rates will go lower, the bond market is less closely tied to these rates because of new developments. Foremost is the prospect of lower oil prices and ongoing progress on inflation. This has cemented inflationary expectations at a much lower level. Also, recent statements by Chairman Volcker have reinforced and clarified his Senate testimony. His concerns for the future no longer address money supply issues. Instead, he speaks generally about inflation fears, applauds the prospect for lower oil prices, and repeats that his own personal feeling is that interest rates can move lower because of progress on inflation. This tone has generally encouraged the bond market.

With the fears of an uptick in bond rates evaporating, the market has moved to take advantage of current yield curve effects. The positively sloped yield curve provides the incentive to carry longer-term issues funded at short-term rates with less fear of capital losses. Indeed, some market observers feel the current inflation progress and oil price outlook might accommodate a cut in the discount rate, a factor which could produce capital gains for bond holders. Thus market sentiment, for the time being, has found a bullish niche.

As the Fed has focused on the monetary aggregate M3, which has a very stable and trendless velocity, monetary aggregates should not pose a problem for the Fed until mid-year (if then). Because first-quarter growth is in the bag and the second quarter will probably carry through with positive growth, there is no prospect of a need to lower rates to stimulate growth in the U.S. Oil price developments may permit one more discount rate cut, but it is likely that this cut would be all for quite a while. Thus the markets feel rather assured of economic developments through mid-year, and this makes the high longer-term yields more attractive, thus bringing long rates down. Barring unforeseen developments, a continuation of the trend to lower yields in the bond market is a good bet, even given the possibility of fits and starts in money market rates.

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Market Yields

	3/4/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	11.00%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.13	14.50
Repurchase Agreements	8.38	8.05	14.70
U.S. Treasury Issues			
Bills			
3 months	8.21	8.13	12.75
6 months	8.39	8.29	13.35
1 year	8.59	8.58	13.48
Coupons			
2 years	9.28	9.28	13.85
4 years	9.64	9.72	13.75
7 years	10.13	10.19	13.65
10 years	10.26	10.25	13.55
Long Bond	10.44	10.47	13.30
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.25	8.15	14.00
3 months	8.25	8.25	13.90
6 months	8.35	8.35	13.85
1 year	8.60	8.90	13.85
Banker's Acceptances			
1 month	8.25	8.10	13.85
3 months	8.25	8.20	13.90
6 months	8.35	8.35	13.85
Eurodollar Deposits			
1 month	8.75	8.88	14.38
2 months	8.75	8.94	14.38
3 months	8.75	8.94	14.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.12	13.72
1 month	8.42	8.17	13.97
3 months	8.13	8.28	13.76
Bank Holding Companies			
1 month	8.04	8.31	13.84
Dealer Placed:			
3 months	8.41	8.41	14.17
New AA Corporate Utility Bond	11.75	11.85	16.13
Tax Exempt			
6 month Project Notes	4.30	4.00	7.20
1 year AAA Bond	4.50	4.50	7.75
5 year AAA Bond	6.00	6.20	9.00
20 year AAA Bond	8.25	8.65	12.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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